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Letter Ruling 97-2: Hub and Spoke Investment Structure

May 23, 1997

You request a letter ruling on behalf of parties^[1] to a multi-tier investment structure referred to as a "Hub" and "Spokes" arrangement. You ask whether a Hub is a partnership for Massachusetts tax purposes and, if so, whether it is required to file an information return. In addition you asked whether investment in a "Hub" creates nexus between a Spoke and Massachusetts under the particular facts presented.

FACTS

The Hub and Spoke structure is described as follows. ***** (the "Trust") is a trust established under the laws of the State of New York. The Trust will be registered as an open end management investment company under the Investment Company Act of 1940. The Trust is authorized to have an unlimited number of sub trusts or "Hubs." Each Hub represents a separate investment series, with the interests therein separate and distinct from the interests in any other Hub. The principal office of the Trust and Hubs is in the Cayman Islands. The Hubs have no employees and they do not maintain an office, telephone or mailing address in Massachusetts.

Each Hub will pool funds from various investors or "Spokes." Only certain institutional investors will be permitted to be Spokes. No individual, S corporation, or partnership and no grantor trust that is beneficially owned by any individual, S corporation or partnership will be permitted to be a Spoke of any Hub. The initial Spokes will consist of various ***** funds. At some future date, each Hub may have additional Spokes which may consist of additional regulated investment companies, segregated asset accounts, bank common trust funds, collective trusts for the investment of retirement plan (including IRA) assets and foreign investment companies. The Spokes are not considered limited partners per se because the Hubs are not organized pursuant to the limited partnership act of any state. However, it is intended that the liability of the Spokes will be limited to their interest in the respective Hub.

Each Hub has applied for a ruling from the Internal Revenue Service to confirm that it will be classified as a partnership for federal income tax purposes. The Trust agreement provides that a Hub may be dissolved at any time by the Trustees or by a vote of a majority of its Spokes. A Hub shall be dissolved effective 120 days after the withdrawal, resignation, retirement, bankruptcy or expulsion of any of its Spokes. However, the remaining Spokes may vote to continue the business of the Hub. The Trust agreement also provides that the interests in the Hubs are not transferable by any of the Spokes. Increases or decreases to a Spoke's interest in a Hub are reflected by

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adjustment to the Spoke's capital account, not by a transfer of interests in that Hub.

The affairs of the Trust will be administered by the Trustees, some of whom are Massachusetts residents. The Trustees may perform due diligence on-shore visits to each Hub's various service providers. However, the Trustees will limit their activities to information gathering and all formal action taken by the Trustees will be performed at an offshore location. To ensure that the Hubs will not be deemed to be engaged in a trade or business in the United States for tax purposes, substantially all of the [Hub] functions will be carried on at offices located outside the United States. See Treas. Reg. 1.846-2(c)(2)(iii).

Representatives from Spokes may travel to Massachusetts to make investigations and inquiries of the personnel of the Hubs and/or the service providers. The purpose of the visits would be to discuss matters related to the Hubs' investment portfolios, investment objectives, risk management, rates of return, and resolution of any problems directly related to the investments. The visits are expected to occur not more than three times a year and each visit is expected to last no longer than 2-3 days. No other contact with Massachusetts is expected and no contracts on behalf of a Spoke will be executed in Massachusetts.

DISCUSSION

I. Partnership Classification and Filing Requirement

The Hub and Spokes arrangement does not appear to be a corporation because the corporate characteristics of continuity of life and free transferability of shares are lacking. Additionally, the arrangement does not appear to be a trust because the Trustees are subject to the control of the certificate holders.^[2] Each Hub has requested a ruling that it will be classified as a partnership for federal tax purposes. Similarly, the Hub and Spokes investment arrangement will be characterized as a partnership for Massachusetts tax purposes, provided it is characterized as a partnership for federal tax purposes. Consequently, the general rule of partnership taxation will apply the partnership itself is not subject to the state income tax but each partner is subject to tax on the partner's distributive share of income received by the partnership. See 830 CMR 63.39.1(8) & 830 CMR 63.38.1(11); see also, G.L. c. 62, § 17 and 830 CMR 62.5A.1(9)(b).

Pursuant to G.L. c. 62C, § 7, every partnership having a usual place of business in Massachusetts shall file an information return. The Hubs do not maintain an office or other place of business in Massachusetts. The activities of the Hubs' Trustees do not establish a usual place of business in Massachusetts for the Hubs. Thus, the Hubs will not be required to file information returns.

II. Nexus

The taxpayer also asks us to consider whether the Spokes, i.e., the foreign corporate partners, have nexus with Massachusetts as a result of the Massachusetts activities of the Hubs, i.e., the partnerships. Section 8(a) of 830 CMR 63.39.1, the Nexus Regulation, explains that a foreign corporation is subject to tax in Massachusetts if it is a partner in a partnership whose activities, if conducted directly by the foreign corporation, would subject that corporation to the corporate excise under G.L. c. 63, § 39.^[3] Similarly, whatever a foreign corporation can do directly without creating nexus can be done indirectly through a partnership without creating nexus.

The Department has described certain investment activities that will not create nexus. A foreign corporation may deposit funds or maintain securities brokerage accounts with unrelated Massachusetts financial institutions without creating nexus. See 830 CMR 63.39.1(6)(e). A foreign corporation may hold a minimal interest in a limited partnership doing business in Massachusetts without creating nexus. See 830 CMR 63.39.1(8)(d). A foreign corporation may obtain investment advice and management services from Massachusetts independent contractors without creating nexus. See 830 CMR 63.39.1(7)(e)(2); see also, Department of Revenue Letter Rulings 91-2, 91-6 and 80-41.

The Hubs are partnerships in which the Spokes are foreign corporate partners. The partnerships conduct investment-related activities in Massachusetts. Those activities include engaging

custodians, investment advisors and attorneys. The Hubs' Massachusetts Trustees may participate in meetings via teleconference from Massachusetts locations. Additionally, the Trustees may perform visits to ensure that the Hubs' service providers, which are independent contractors, are meeting their responsibilities with due diligence. Meetings of the Hubs' Board of Trustees are not carried on in Massachusetts, even though some of the Hubs' Trustees are Massachusetts residents. Based on the above, we conclude that the Hubs' partnership activities do not create nexus on the part of the Spokes.^[4]

The Spokes as foreign corporate partners may have nexus with Massachusetts by directly engaging in Massachusetts in activities other than those described above. The facts state that the Spokes may make infrequent trips to Massachusetts for the limited purpose of investment consultation and that no contracts will be executed in Massachusetts. This activity is limited enough in purpose and extent so as not to establish nexus and subject a Spoke to tax under G.L. c. 63, § 39.^[5] Cf. Department of Revenue Letter Rulings 91-6 and 91-2.

CONCLUSION

The Hubs will be classified as partnerships for Massachusetts tax purposes and the Spokes will be partners in the Hubs. Because the Hubs do not have a usual place of business in Massachusetts, they will not be required to file information returns. The Spokes will not be subject to the Massachusetts excise under G.L. c. 63, § 39, provided that they do not execute contracts in Massachusetts or undertake business activities (either directly or through the Hubs) apart from those described above.

Very truly yours,

/s/Mitchell Adams

Mitchell Adams
Commissioner of Revenue

MA:HMP:lbr

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^[1] The parties to the request include

***** and various Spokes as described in the facts of the ruling.

^[2] We emphasize that this ruling is limited to its facts. Occasional visits to Massachusetts by corporate agents or employees may constitute "doing business" if conducted for other purposes.

^[3] Individual partners are subject to tax under G.L. c. 62, § 17 and 830 CMR 62.5A.1(9).

^[4] Where the trustee is subject to the control of the certificate holders, the entity will be classified as a partnership. See Department of Revenue Letter Rulings 93 12, nn. 1&2; 93 11; and 93 14 (citing *Frost v. Thompson*, 219 Mass. 360 (1914); and Treas. Reg. § 301.7701-4). The Declaration of Trust considered in this ruling indicates that the Spokes have the power to vote on election and removal of Trustees, investment advisory contracts, amendment of the Declaration of Trust and termination of the Hub.

^[5] The foreign partners of the partnership might have nexus with Massachusetts by virtue of the partnership's activities if it engages in Massachusetts activity other than that described above.